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IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1943.

FEDERAL POWER COMMISSION, CITY OF AKRON, AND PENNSYLVANIA PUBLIC UTILITY COMMISSION, Petitioners,

v.

HOPE NATURAL GAS COMPANY.

**BRIEF ON BEHALF OF THE NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS, AMICUS CURIAE.**

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October 16, 1943.

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### OPINIONS BELOW.

The opinion of the Circuit Court of Appeals is reported in 134 Fed. (2nd) 287, and will be found in the record herein in Vol. IV, page 169. The opinion of the Federal Power Commission has not been officially reported, but can be found in 44 P. U. R. (NS) 1, and will be found in the record herein in Vol. I, page 14.

## PRELIMINARY STATEMENT.

The National Association of Railroad and Utilities Commissioners, hereinafter called the Association, is a voluntary association, embracing within its membership the membership the members of the regulatory commissions and boards of the several states of the United States except two, one of which has no state regulatory commission.

By the constitution of the Association, the Executive Committee of the Association may direct the General Solicitor to appear on behalf of the Association (as distinguished from a particular commission represented in its membership) in any proceeding pending before any court or commission in which, in the judgment of said Executive Committee, appearance on behalf of the Association should be made.

This brief is offered for filing on behalf of said Association, in the general public interest, by direction of the Executive Committee of said Association given in a resolution, adopted by said Committee, reading as follows:

“Resolved, that the legal representatives of this Association be directed to file an *amicus curiae* brief on behalf of the Association in the *Hope Natural Gas Company* case now pending in the United States Supreme Court, reaffirming the position heretofore taken with respect to valuation for rate purposes in the *Natural Gas Pipeline Company* case.”

## STATEMENT OF THE CASE.

A full statement of the case, to which we refer, is contained in the brief of the Petitioners herein, beginning at page 4 of that brief. As a basis for the argument contained in this brief, the following summary statement is made.

The Hope Natural Gas Company, hereinafter called Hope, is a natural gas company which produces natural gas in West Virginia. It sells a part of the gas so produced in that State, and sells the remainder in interstate

commerce to other companies, which make resale thereof to the public in the States of Ohio and Pennsylvania.

On October 14, 1938, upon consideration of complaints before it, the Federal Power Commission entered upon an investigation of Hope's rates and charges, with the purpose of fixing such rates and charges, subject to its jurisdiction, if found to be unjust, unreasonable or discriminatory, upon a just, reasonable and non-discriminatory basis (R. Vol. I, p. 28). With that purpose it held a hearing, and made a valuation of Hope's properties. At such hearing Hope was afforded full opportunity for the introduction of evidence, and for the cross examination of witnesses, produced by other parties to the proceeding, and was heard in oral argument.

At the hearing Hope presented evidence as to the original cost of its properties, claiming such cost to be \$69,735,637. It likewise produced evidence as to what it termed the "original cost trended to 1938 prices," which was claimed to amount to \$105,101,912 (R. Vol. I, p. 193). Hope also introduced evidence of a claimed reproduction cost new of its properties amounting to \$97,340,000 (R. Vol. I, p. 163 and R. Vol. IV, p. 171).

In an opinion rendered on May 26, 1942, concerning Hope's evidence of reproduction cost and of trended original cost, the Commission said in part:

"After full consideration of the estimate of reproduction cost new presented by the Company, we find that it is not predicated upon facts and that it is too conjectural and illusory to be given any weight in these proceedings. \* \* \*

"The Company also presented a trended 'original cost' estimate which exceeded \$105,000,000. \* \* \* The evidence discloses fundamental errors in the trending process used. \* \* \*

"In the light of the evidence the conclusion is inescapable that the Company's trended 'original cost' estimate is not founded in fact, but it is basically erroneous and produces irrational results.

"The reproduction cost studies and the so-called trended 'original cost' studies were the typical, hypo-

thetical conjectures which have plagued rate regulation for more than forty years. The actual development and experience of the Hope Company were ignored. In addition, assumption upon assumption as to material and labor costs, and magnified imagination as to overheads were indulged in lavishly. The results have no probative value and accordingly must be condemned." (R. Vol. I, pp. 21-23)

Concerning Hope's claimed original cost, the Commission, in its opinion, said in part:

"The first step in the Company's determination was the taking of an inventory. The inventory units were then priced at estimated cost, including arbitrary overheads. The amounts shown as plant costs by the books were ignored, except for the purpose of aiding in estimating unit costs. As is shown by Table A, the Company's method resulted in a claimed net increase of \$17,004,972 over the amount recorded as investment in the interstate properties on its books of account. The Company claims, in other words, that its books fail to show the true cost of such properties in that amount. The items of that amount which are identifiable represent expenditures previously charged to expense accounts. Some of the alleged expenditures were not incurred at all." (R. Vol. I, p. 24)

The Commission, in its opinion, found that the recorded book cost of Hope's properties was \$52,730,666, but that certain charges were erroneous, and that certain items had been omitted. Correcting these errors, the Commission found the actual legitimate cost, or gross plant investment to be \$51,207,621. (R. Vol. I, p. 36).

Hope claimed that items of expense for well drilling, and other purposes (not appearing on its books as part of its recorded investment), which, under the Commission's present system of accounts, may be charged to capital/investment, should now be included in the Commission's finding of original cost. The Commission rejected that contention, for reasons stated at length in its opinion. (R. Vol. I, p. 31) At the same time the Commission did include in its original cost finding items aggregating \$1,295,953 representing plant

costs which were originally capitalized and later charged off to operating expenses. (R. Vol. I, p. 35)

The Commission also included, in its rate base finding hereinafter stated, \$1,392,021 for the estimated cost of net capital additions up to the end of 1943, also \$566,105 for unoperated acreage adjudged useful and \$2,125,000 for working capital, including materials and supplies. (R. Vol. I, p. 50)

The Commission found the accrued depreciation of Hope's properties to be \$22,328,016. In making this finding the Commission used the so-called straight line depreciation method, to determine the annual depreciation for each year, it applied depreciation rates based upon the estimated service life of property, to the original cost of that property, with proper allowance for salvage value. The service lives, upon which the depreciation rates used were based were determined upon the evidence of a qualified engineer, upon the staff of the Commission, who testified as follows:

"During the course of the determination of the average service lives of this property, numerous and detailed inspections were made of all classes of property in the system. This includes an inspection of all visible property subject to examination such as structures and compressing station equipment and sample inspections at many points of the underground pipe and buried property comprising the pipeline system. I also made analyses to determine the property retirement experience of the company covering property whose service life had been terminated and the depreciation realized and a review of the maintenance policy and operating practices over the forty-year history of the company. In addition, a study was made of the service age of the principal identifiable units of the company's property. (Service age is the period of time between the date when property is first placed in service and the date of the investigation.) Careful consideration and effect was also given to all of the relevant facts determinable concerning the probable future life expectancy of the principal physical units of property. In addition to the extensive inspection and study of the company's property, there was available during the process

of determining the average service lives for all classes of this property, considerable relevant data from the following sources: (enumerated)" (R. Vol. III, p. 158)

The Commission in its opinion indicated its reasons for attributing no weight to Hope's evidence in support of its claims of original cost, trended cost, and cost of reproduction new. Also, referring to its own finding of original cost, the Commission said:

"This actual legitimate cost is predicated upon facts and it is the best evidence in these proceedings, so we will employ it for determining the proper and allowable rate base." (R. Vol. I, p. 36)

After indicating the reason for deducting accrued depreciation and for consideration of the other items added to the original cost, as found by it, the Commission said:

"The Commission, therefore, adopts the foregoing amounts as the interstate rate base for the dates indicated, for the Company's property assembled as a whole and doing business as part of an integrated system. The Commission finds \* \* \* that the rate base for fixing future rates is \$33,712,526." (R. Vol. I, p. 50)

The Commission found 6½ per cent to be a fair rate of return for Hope. (R. Vol. I, p. 67) The Commission further found that Hope's earnings under existing rates produced net operating revenues in excess of 6½ per cent upon the rate base found by the Commission in the amount of \$3,609,857, and that such existing rates were to that extent unreasonable. It accordingly, by order, prescribed rate reductions designed to reduce Hope's net operating revenues to approximately 6½ per cent upon the rate base found. (R. Vol. I, pp. 1, 70 and 72)

Hope by petition sought a review of the Commission's order in the United States Circuit Court of Appeals for the Fourth Circuit, alleging confiscation of its property (R. Vol. IV, pp. 1 and 19) That court, with one judge dis-

senting, set aside the Commission's order upon grounds which are fully stated in its opinion (R. Vol. IV, p. 169) from which the following excerpts are quoted:

"The vital questions in the case relate to the determination of the rate base; and, in view of the low rate of return allowed and the consequent lack of margin to take care of error in the base, the rates allowed must be condemned as unreasonable and confiscatory because of the following errors with respect to the valuation of the property constituting the base; (1) the Commission did not find the present fair value of the property and took no account of the change of price levels in determining the rate base; (2) the Commission ignored items of well drilling costs and overhead, aggregating in excess of \$17,000,000, which entered into the original cost of the property, basing this action on the fact that, under the system of accounting that prevailed at the time, these items had been charged on the company's books to expense; and (3) the Commission ignored evidence as to the present condition of the property and computed accrued depreciation theoretically on the straight-line service-life method." \* \* \* (R. Vol. IV, p. 172)

"The report of the Commission shows, not only that it gave no consideration to rise in price levels in determining the amount of the rate base, but also that it made no attempt to ascertain the present fair value of the property involved. It adopted as the rate base the original cost of the property as shown by the company's books, adjusted to correct bookkeeping errors and depreciated as above indicated." \* \* \* (R. Vol. IV, p. 172)

"Not to be confiscatory, rates must allow a fair return upon the present fair value of the property. To determine this fair return upon present fair value, the Commission must find what the present fair value of the property is." \* \* \* (R. Vol. IV, p. 184)

"In the pending case, original investment cost cannot be taken alone as a measure of the present fair value of the property because of the great changes in the prices of labor and materials which have occurred over the more than forty years during which the investments in the property have been made. These

changes are matters of general and common knowledge and are shown by many publications, statistical reports and other documents readily available. That such changes have occurred is shown also by the evidence offered before the Commission. It is true that the statements of reproduction cost and trended original cost fail to allow for the increased productivity of labor and fail to take account of other pertinent factors; and the Commission, we think, was justified in refusing to accept the conclusions therein contained. But this does not mean that the Commission could ignore the change in price levels which was clearly established and was matter of general and common knowledge otherwise. The Commission's staff prepared statements showing that the conclusions of Hope's reproduction cost and trended cost statements should not be accepted. They could doubtless have furnished estimates as to the proper effect to be accorded price trends in the correct valuation of the property. At all events, the Commission should have given consideration to the matter; and, if of opinion that investment cost was a true measure of the present value of the property notwithstanding increase in prices, it should have found this as a fact. It could not absolutely ignore the fact of increased price levels in determination of present fair value." \* \* \* (R. Vol. IV, pp. 180-181)

"The Commission computed accrued depreciation by applying the straight-line service-life method to its properties, i. e. by finding a rate of depreciation based on the average service life of property, multiplying this by the years the property had been in use, and applying this percentage to the book cost of the property." \* \* \* (R. Vol. IV, p. 189)

"Many of the consequences complained of will be eliminated when the present value of the property is considered in the light of changed price levels and the depreciation percentage is applied to the higher valuations resulting. We think, however, that the Commission may not close its eyes to the actual present condition of the property in determining present value and compute depreciation on the basis of mere formulas, as it has done in this case." \* \* \* (R. Vol. IV, p. 190)

"It is clear, we think, that annual depreciation must be computed on the basis of the present fair value of the property." \* \* \* (R. Vol. IV, p. 194)

**QUESTIONS TO BE ARGUED HEREIN.**

This brief is filed in support of the following propositions:

1. The court below erred in holding that the Federal Power Commission did not find the present fair value of the properties of Hope, in the sense that "fair value" is required to be found by the decisions of this court.
2. The court below erred in holding that the Commission gave no consideration to relevant matters of common knowledge nor to the evidence as to changes in price levels which had occurred since Hope started operation.
3. The court below erred in holding that the Commission was required, as a part of the rate-making process, to determine price trends during the history of the property valued and the effect thereof upon the reproduction cost of such property, and to give effect thereto in fixing the rate-making value of such property.
4. The court below erred in holding that the Commission should have included in its finding of original cost the items of expense for well drilling and other purposes which were charged to operating expenses by Hope, when the same were incurred, and hence were not included as capital cost items by the Commission.
5. The court below erred in holding that the Commission determined the accrued depreciation of Hope's property with eyes closed as to the actual present condition of the property and without consideration of such actual condition.
6. The court below erred in holding "that annual depreciation must be computed on the basis of present fair value of the property."
7. The court below erred in holding the rates prescribed by the Commission to be unreasonable and confiscatory.

**SUMMARY OF ARGUMENT.**

1. The Commission found the "fair value" of Hope's property in the sense that "fair value" is required to be found under the decisions of this Court. The decision below to the contrary is based upon a misconstruction of what the Commission did. The two sentences in the Commission's opinion, upon which the Court below seized, to support its misconstruction, do not have the meaning attributed to them below, when read with their context, and in the light of the entire opinion.

The Commission recognized its duty to find a rate base, it discussed Hope's evidence, and stated its reasons for not giving weight to the same, and also its reasons for considering its own original cost finding "the best evidence"; and it announced its purpose to employ its own finding "for determining the *proper* and *allowable* rate base." The Commission likewise discussed its reasons for deductions from and additions to original cost, as found by it, and announced the rate base adopted "for the company's property assembled as a whole and doing business as part of an integrated system."

In *California Railroad Commission v. Pacific Gas and Electric Co.*, 302 U. S. 388, an almost-precisely similar case, the Commission did not denominate its rate base finding as "value" or "fair value" but the court sustained the rate order based thereon.

2. The Commission was not required to make a reproduction cost finding, by the use of price trends, or by any other method. In effect, the court below ruled that it is an indispensable part of the rate-making process for the Commission to make a reproduction cost estimate by some method.

To obligate the Commission to use price trends is the equivalent of prescribing a formula for finding rate value, which, in applicable decisions, this Court has held the Constitution does not contemplate.

3. The decision below, that the rate-making method followed by the Commission in this case was unconstitutional, invites an amplification of the pronouncement made by this Court in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. 575. In the Association's brief in that case argument was made at some length, here repeated, that the *Smyth v. Ames* rule, properly understood and applied, leaves freedom to rate-making agencies to value property for rate-making purposes according to its own independent judgment, and that, under applicable decisions, rate-making value may be based upon original cost evidence.

In the *Natural Gas Pipeline Company* case, this court made a pronouncement which is believed intended to affirm such a construction of such applicable decisions. It is suggested that it is desirable that the Court in this case make clear that such pronouncement was so intended.

4. The Commission properly used the straight-line method in determining the extent of accrued depreciation, and computed such depreciation upon the original cost of the property depreciated. The opinion in *United R. & E. v. West*, 280 U. S. 234, requiring depreciation to be based on the present "fair value" of the property, is unsound, and should be over-ruled. It is unsound because it lays down a rule impossible of application.

In determining depreciation in this case, the Commission did not proceed with its eyes closed, nor without considering the actual condition of the property. The rates of depreciation used were estimated by a competent engineer, who carefully inspected the property to be valued, and estimated depreciation lives upon consideration of the age and condition of such property.

5. The Commission properly refused to include in the original cost found well drilling costs and overheads connected therewith which were charged to operating expenses when incurred, in accordance with an established policy of the company.

6. The pronouncement of the court in the *Natural Gas Pipeline Co. case* is construed to mean that a regulatory commission may determine its own formula for finding value. The decision below evidences that the pronouncement is not so understood by some Judges of eminence. An amplification of the pronouncement would accordingly aid regulatory commissions and federal and state courts.

The pronouncement in the *Natural Gas Pipeline Co. case*, as construed in this brief, appears to leave the law exactly as it should be. No single formula for finding rate base value should be prescribed, but rate regulatory commissions should be free to determine rate-making formulas.

7. The Commission's order, viewed in its entirety, produces no arbitrary result.

### ARGUMENT.

#### **The Commission Found the Fair Value of Hope's Property, in the Sense That "Fair Value" is Required to be Found Under the Decisions of This Court.**

The decision of the court below is based upon a misconstruction of the Commission's decision, which the court places upon that decision by reason of certain language in the Commission's opinion. In this respect the case is identical with *California Railroad Commission v. Pacific Gas and Electric Company*, 302 U. S. 388, as will be later pointed out herein.

In its opinion in the case now before this court, the Commission at one point said:

"With the decline in favor of the doctrine of 'fair value' as the only mode of public utility rate regulation, its keystone, reproduction cost, crumbles. *Bona fide* investment figures now become all important in the regulation of rates." (R. Vol. I, p. 32)

The court below, in its opinion, seized upon these sentences in the Commission's opinion, and treated them as

the equivalent of a ruling by the Commission that bona fide investment constitutes the rate base, and that other evidence was to be ignored.

The Commission did in fact base its finding of a rate base upon original cost, to which, in making its finding, it simply added other items of expense by Hope, which the Commission found justly ought to be taken into consideration. Because the Commission chose to adopt that formula in making its finding, the Court of Appeals ignored the fact that the Commission made a finding. Pointing to the language of the Commission quoted above (R. Vol. IV, p. 172), the court treated the Commission's action and opinion as establishing that (1) "the Commission did not find the present fair value of the property and \* \* \* (2) \* \* \* ignored items of well drilling cost and overhead \* \* \*, and (3) \* \* \* ignored evidence as to the present condition of the property and computed the accrued depreciation theoretically \* \* \*."

The court thus attributed to the above quoted declaration by the Commission, respecting the decline in favor of the doctrine of "fair value" and respecting the "all important" character of bona fide investment, a significance which plainly is not tenable, when that declaration is read with its context, and in the light of the entire opinion of the Commission.

The declaration is found in the Commission's discussion of Hope's claim, made for the inclusion in original cost, and for reflection in the rate base found, of various items of expense which Hope claimed were incurred in the acquisition of property. Hope had included these items in its claimed original cost, and, in its claimed cost of reproduction new, had likewise included the estimated cost of reproduction new of the property alleged to have been acquired by said claimed expenditures.

The items in question were not found recorded in the investment accounts, but were alleged to have been charged to expense. The Commission refused to recognize the inclusion of such items as capital, saying that the attempt

thus to recast books of account, upon the basis of an inventory, with items of property priced at "estimated 'actual cost'" is the equivalent of estimating reproduction cost, which has fallen into disfavor; and that such an "estimated 'original cost'" represents an attempt to tamper with bona fide investment figures, which have now become "all important", by applying to the determination of actual cost "the reproduction cost *process* \* \* \* permeated with conjectural estimates." That the declaration had no broader application is plain, when it is read in its context, which we here quote as follows:

"The past determinations of the items constituting plant investment were deliberate, conscious acts on the part of management at the time of the transactions. A decision obviously must be made when an expenditure occurs as to whether it represents an investment in plant or an expense. There must also be some finality to these decisions. If they are treated as expenses at one time and as plant investment subsequently, chaos in rate-making and in corporate finance will prevail. \* \* \* The Company kept plant and expense accounts throughout its history and conformed to the general business practices of the industry and like business institutions. It was evidently thoroughly convinced as to the propriety of its decisions, as witness its claim before the West Virginia Commission in 1921, that the very expenditures in question were operating expenses. The Company is now estopped from re-accounting for those expenditures.

"With the decline in favor of the doctrine of 'fair value' as the only mode of public utility rate regulation, its keystone, reproduction cost, crumbles. Bona fide investment figures now become all important in the regulation of rates. Immediately, however, we find an effort to tamper with these. There is in progress an attempt to make the reproduction cost *process* survive in the determination of actual cost of or investment in plant. Thus, in this case an inventory was taken and then units were priced at the estimated 'actual cost.' The method should be condemned at the threshold. For in addition to being permeated with conjectural esti-

mates, it gives no heed to the realities of past events. Consistent treatment of expenses and plant investment costs is indispensable to the successful operation of the regulatory system." (R. Vol. I, p. 32)

The Commission unquestionably made no finding of the true cost of reproduction; and its reference to the decline in favor of the "fair value" doctrine "as the only mode of utility rate regulation," plainly had reference to a method of determining a rate base in which a reproduction cost determination was considered as an indispensable element for consideration.

The Commission recognized its duty to find a rate base. In making such finding it considered the estimates which Hope had introduced and indicated its reasons for not giving weight either to the original cost claimed or to the claimed "trended original cost or to the claimed reproduction cost new." Thereupon, referring to its own finding, the Commission said:

"This actual legitimate cost is \* \* \* *the best evidence* in these proceedings, so we will employ it for determining the *proper* and allowable rate base." (R. Vol. I, p. 36)

Having stated its reason for considering its original cost finding as the best evidence upon which to rest a rate base finding, the Commission stated its reasons for deducting its estimate of accrued depreciation, and its reasons for certain additions, saying: "The Commission, therefore, adopts the foregoing amounts as the interstate rate base for the company's property assembled as a whole and doing business as part of an integrated system. The Commission finds \* \* \* that the rate base for fixing future rates is \$33,712,526. (R. Vol. I, pp. 36 and 50)

In the face of the language of the Commission's opinion, to which we have above adverted, it appears plain that the court below erred in saying that the court "ignored" the evidence offered by Hope, or that it did not find the present

fair value of the property involved, unless (1) the constitution requires that such finding be based upon reproduction cost or (2) the constitution requires that such a finding must expressly denominate the rate base finding a finding of fair value. The constitution requires neither, as this court has expressly held in recent decisions.

In *California Railroad Commission v. Pacific Gas and Electric Company*, 302 U. S. 388, the California Railroad Commission had received evidence presented by the utility as to the reproduction cost of its property, but had refused to make use of the same in determining the rate base, stating in its report, that it found the same unsatisfactory. In its report the Commission said:

"During its entire history in establishing reasonable rates for utilities similar to this company, to determine a proper rate base this Commission has used the actual or estimated historical costs of the properties undepreciated, with land at the present market value. \* \* \* This historical method has dominated the Commission's findings for several principal reasons." (302 U. S. 394)

The United States District Court enjoined the enforcement of the Commission's rate reduction order upon the ground that the Commission had failed to find the fair value of the property in accordance with the requirement of decisions of this court. The District Court pointed to the above quoted language in the Commission's report and said:

"An examination of the opinion and order of the Railroad Commission shows that they did not undertake to ascertain the fair value of the property nor a fair return upon that value. They did fix the rate base at approximately the historic cost and estimated the fair return on that base as \$7,000,000. \* \* \*

"In view of the rejection by the Commission of all evidence concerning the cost to reproduce the property, and in the absence of a specific finding as to the fair value of the property, the question is whether the de-

cision of the Commission can stand as against a charge that the plaintiff had been denied due process of law. • • •

"It is clear from the decision of the Supreme Court in *West v. C. & P. Tel. Co.*, *supra*, that it is a denial of due process for the state regulatory body to refuse to consider proper evidence of the cost of reproduction and that rates fixed in that manner are illegal and void. *A fortiori*, it is a denial of due process to refuse to consider any evidence of the cost of reproduction." • • • (13 Fed. Supp. 935-936)

It would seem that the cited case and the case now before this court were as precisely similar as it would be possible for two cases to be. When the *Pacific Gas and Electric case* was decided here, this court brushed aside the misconstruction which the District Court had placed upon the Commission's decision. Recognizing the right of the Commission to reject evidence considered by it, if found not entitled to weight, the court said:

"The Commission was entitled to weigh the evidence introduced, whether relating to reproduction cost or to other matters. The Commission was entitled to determine the probative force of respondent's estimates. That the Commission did so is apparent from both its statement to that effect and the reasons it gives for considering these estimates to be without positive value. • • • Nor did the ruling with respect to the weight of evidence as to reproduction cost leave the Commission without evidence of the value of respondent's property. We have frequently held that historical cost is admissible evidence of value. • • • In the instant case we cannot say that the Commission in taking historical cost as the rate base was making a finding without evidence and therefore arbitrary. • • • The Commission specifically found what it considered to be the rate base. 39 Cal. R. C. *supra*, p. 76. The Commission found that rate base to be reasonable. *Id.* p. 77, note. The import of its opinion is that the rate base represented the Commission's conclusion as to the value which should be placed upon respondent's property for the purpose of fixing rates." (302 U. S. 388, 397, 398, 399, 400)."

In this case, now before the court, the Commission's opinion, read as a whole, demonstrates that the Commission gave much consideration to the evidence offered by Hope, and refused to give weight to the same for reasons which were persuasive to it; and that it treated original cost, as determined by the Commission, and other items of expenditure which it held entitled to consideration, as "evidence" for determining a "*proper* and *allowable* rate base." The entire opinion evidences an intent to deal fairly with the utility, and various important questions which might have been determined adversely to the utility were decided in its favor.

It is plain, upon a reading of the entire opinion, that the Commission understood its duty to find a fair rate base, and that it made such finding upon a proper consideration of all the evidence before it.

**The Commission Was Not Required to Make a Reproduction Cost Finding by the Use of Price Trends or by Any Other Method, Nor to Denominate Its Rate Base Finding as a Finding of "Value".**

The ruling in the court below is the equivalent of a holding that it was the Commission's duty, as a part of the rate-making process, to make an estimate of the present reproduction cost of Hope's properties. The court below concurred with the Commission, as to the untrustworthy character of Hope's evidence, both as to reproduction cost and as to trended original cost, saying:

"It is true that the statements of reproduction cost and trended original cost fail to allow for the increased productivity of labor and fail to take account of other pertinent factors; and the Commission, we think, was justified in refusing to accept the conclusions therein contained. But this does not mean that the Commission could ignore the change in price levels which was clearly established and was matter of general and common knowledge otherwise. The Commission's staff

prepared statements showing that the conclusions of Hope's reproduction cost and trended cost statements should not be accepted. They could doubtless have furnished estimates as to the proper effect to be accorded price trends in the correct valuation of the property. At all events, the Commission should have given consideration to the matter; and, if of opinion that investment cost was a true measure of the present value of the property notwithstanding increase in prices, it should have found this as a fact." (R. Vol. IV, p. 180)

The court below thus, in effect, ruled that it is an indispensable part of the rate-making process, when substantial changes in price levels have occurred during the history of the property involved, for the Commission to make an estimate of reproduction cost by some method. Price trend evidence unrelated to the property to be valued would be of no significance. There must be an inventory of the property, to which the evidence may be applied. The price and the date of acquisition of each piece of property must be known. The original cost price can then, by application of the price trend from the time of purchase of such property until the date of valuation, be translated into the "trended original cost price," as of the date of valuation, and an aggregate trended original cost price can thereby be obtained.

It is obvious that this is nothing more nor less than a reproduction cost estimate made by a new method, no less hypothetical than the old estimated reconstruction method.

To hold that the Commission was obligated to determine price trends, and to make use of them in determining the rate base, is the equivalent of prescribing a formula for finding rate value, which this court has repeatedly decided the constitution does not impose. *Minnesota Rate Cases*, 230 U. S. 352, 434; *Los Angeles Gas and Electric Corp. v. Railroad Commission*, 289 U. S. 287, 306; *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 586.

In the *National Gas Pipeline Company* case just cited, the utility offered evidence of reproduction cost value, without inclusion therein of any amount to cover the going concern element. For the going concern element it made a claim of \$8,500,000, and offered much evidence in support thereof.

The Commission disallowed the \$8,500,000 claim, saying:

"The companies' claim of \$8,500,000 for going concern value must be disallowed. The amount obviously is an arbitrary claim, not supported by substantial evidence warranting its allowance. Its allowance would mean the acceptance of a deceptive fiction, resulting in an unfair imposition upon consumers. We are convinced that we are allowing in our rate base more than an adequate amount to cover all elements of value."

"In disposing of the motion for interim order, we are accepting at this time the companies' estimates of

Reproduction Cost New of Physical Properties (exclusive of Gas Reserves) ....	\$56,302,250
Value of Gas Reserves .....	13,334,775
Capital additions for the period June 1, 1939 to December 31, 1942 .....	3,808,399
Working capital .....	975,000
 Total Rate Base .....	 \$74,420,424

"The foregoing amount allowed as a rate base may be compared with book cost of properties, plus working capital of \$975,000, as of December 31, 1939, totaling \$60,952,279, and therefrom it is clearly disclosed that the rate base presently allowed herein is liberal."

Upon the rate base so found the Commission, in an interim order, ordered a reduction of rates. This order was set aside by the Court of Appeals upon the ground that the Commission had failed to make any allowance for the going concern element. In reaching this conclusion, the Court of Appeals followed the same line of reasoning as has been followed by the Court of Appeals in this case, pointing out that the rate based used was identical with the reproduction cost claimed by the utility. In this connection also the court said:

"Moreover, in its opinion, the Commission said, 'The companies' claim of \$8,500,000 for going concern value must be disallowed. The amount obviously is an arbitrary claim, not supported by substantial evidence warranting its allowance.'" (Natural Gas Pipeline Company, et al v. Federal Power Commission, 134 Fed. (2d) 287)

That decision of the Court of Appeals, in the *Natural Gas Pipeline Company case*, this court over-ruled, pointing out that, while no item for going concern value was separately stated in the Commission's opinion, the Commission spoke of the rate base arrived at as "liberal" and as a "generous allowance." The court thus treated the finding of the Commission, which was not denominated a finding of value, as a finding which met the requirements of the constitution, as construed by this court. Thus again, as in the *Pacific Gas and Electric case*, above cited, the court refused to isolate a fragment of a Commission opinion, or report, and to allow the language of such isolated fragment to support a ruling that the Commission had failed to do what a reading of the entire opinion or report, fairly indicates, that the Commission in fact did.

The decision in the *Natural Gas Pipeline Company case*, accordingly established the rule to be that a regulatory commission is not required by the constitution to make a reproduction cost finding, or expressly to denominate its rate base as a finding of "value" as a part of the rate-making process.

The attack which is made in this case upon the Commission's rate order, based upon the claim that the method which it followed in reaching a rate base was unconstitutional, because such rate base was rested, in substantial part, upon evidence of original cost, invites an amplification of the pronouncements heretofore made by this court touching that subject. In the *Natural Gas Pipeline Company case* the Association, in an *auctiis curiae* brief, asked for a clear pronouncement covering the subject.

The paragraphs following, under the caption "Paragraphs from the Association's Brief in the Natural Gas Pipeline Company Case", are deemed as applicable to this case as they were in the *Natural Gas Pipeline Company case*.

#### Paragraphs from the Association's Brief in the Natural Gas Pipeline Company Case.

Under the decisions of this Court, the test as to the constitutional validity of rates, fixed by legislative authority, has been the sufficiency of such rates to yield a fair return on a rate base, which the Commission has denominated "fair value."

The fair value test was first announced in *Smyth v. Ames*, 169 U. S. 466. The language of that case is often referred to as the *Smyth v. Ames* rule. It is obvious, however, that it is no rule at all, beyond its requirement that "fair value" be found, and used as a basis for determining rates which the owner of the property involved must be permitted to earn to avoid confiscation.

The use of reproduction cost estimates became common, and was treated as proper by this court. *Denver v. Denver Union Water Co.*, 246 U. S. 178, 191. In *Southwestern Bell Tel. Co. v. Public Service Commission*, 262 U. S. 276, the court went so far as to set aside the Commission rate order involved in that case, because it appeared from the Commission's report that it had not based its findings of fair value upon reproduction cost prices as of the date of the valuation. See also *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 410.

The cost and delays incident to recurring reproduction cost estimates were so great that attempts were made to obviate the necessity for them by the development of cost indices showing the trend of reproduction cost prices, which could be used to indicate the change in the reproduction cost of property from one date to another. The difficulties

inherent in the attempts, or in the manner in which they were used, led to the rejection of their results in court. *West v. Tel. Co.*, 295 U. S. 662, 667. *Ohio Bell Tel. Co. v. Public Utilities Commission*, 301 U. S. 292, 296

The results of attempting to follow this *Smyth v. Ames* rule, as it had been thus developed are well known. They were commented upon in the dissenting opinions of Mr. Justice Brandeis in *St. Joseph Stockyards Co. v. United States*, 298 U. S. 73, 84, and, of Mr. Justice Black in *McCart v. Indianapolis Water Co.*, 302 U. S. 419, 435.

Some Commissions refused to undertake to make physical valuations under the *Smyth v. Ames* rule, and frankly followed the practice of treating the investments of companies as a sufficient basis for determination of their rate bases. Notable among these was the Railroad Commission of California.

This practice of the California Commission came squarely before this court in *Railroad Commission v. Pacific Gas and Electric Co.*, 302 U. S. 388, above cited.

As originally expressed, the so-called *Smyth v. Ames* rule had not exalted reproduction cost evidence above every other class of evidence mentioned, nor held that reproduction cost represented minimum fair value, to which additions must be made for other elements of value, if existing. Care had been taken by the Court in *Smyth v. Ames* to make it clear that the enumeration of elements to be considered was not designed to be exclusive, and that the weight to be attributed to each class should be what the valuing tribunal deemed "just and right in each case." The Court was not laying down a rule to deprive legislators and legislative rate making-agencies of the exercise of their judgment. *Minnesota Rate Cases*, 230 U. S. 352, 434.

When Mr. Justice Hughes had become the Chief Justice, and came to write the opinion in the *Pacific Gas and Electric Company* case, from which we have quoted, he but expressed again what he had said more than twenty years

before. The opinion in the *Pacific Gas and Electric Company case* simply cleared away excrescencies from the rule as originally expressed by Mr. Justice Harlan.

Under the law, as recognized and emphasized in the later opinion, a rate-making agency may weigh the relevant evidence before it, and, attributing to each piece of evidence the weight it considers just, may determine the amount upon which the owner of the property regulated should be permitted to earn a return; and within the limits of the constitutional rule, which forbids confiscation, its decision is final.

There is no requirement in the constitution, nor in the decisions of this court, which compels a regulatory agency to attempt to segregate the intangible elements of a utility's property, such as its established business, from its tangible physical properties, and to determine and state a value for such intangible elements.

We join with counsel for the gas companies in considering that clarification of the situation is necessary, and join them in asking for it. Our view is that a clarification is necessary for the purpose of enabling such commissions, with confidence, to apply the rule announced in *Smyth v. Ames*, according to its original intent, as reestablished by the opinion in the *Pacific Gas and Electric Co. case*.

We ask the Court to make it clear that a rate regulatory commission may make its determination of the rate base without any attempt to determine the reproduction cost of properties, unless the evidence before the commission is such as to show that justice requires such cost to be estimated and considered in fixing the rate base.

It ought not to lie within the power of a utility to compel a regulatory commission to choose between expending large sums of public money to make reproduction cost estimates (which the commission knows to be not necessary for a just appraisal), or to allow a one-sided record to be made by the utility, at the expense of the rate payers, in which professional, so-called experts will present evidence of val-

uations which will consume months of time in the presentation, but will, when presented, be of no aid to the commission in reaching its determination.

If it is the judgment of the commission that estimates of reproduction cost will, in fact, be less dependable than original cost, as an aid in the determination of a proper rate base, why should the commission be compelled to consume months or years in either making or receiving such estimates? If, after the record is made, the commission may exercise its judgment to attribute controlling weight to original cost, and to disregard reproduction cost estimates, —as it may under the Pacific Gas and Electric Co. opinion, —may it not use its judgment, before the estimates are made, and rule that it will exclude such evidence.

If the Court will make such a pronouncement, it will protect the rights of all parties. It will save vast amounts of money now being wasted in the preparation and presentation of such estimates, and it will enable the regulatory commissions of the country to perform their rate making function more effectively, because they will be enabled to avoid the expense and the interminable delays which are inevitable, when utilities may demand the right to make and present reproduction cost appraisals.

The right of utilities to judicial protection against confiscation would not be jeopardized by such a pronouncement, since a utility always could come into court upon a claim of confiscation. When the facts are such as to make necessary a determination of the reproduction cost to avoid confiscation, the Court can act, if such determination is denied by the regulatory commission. For example, if we should come into a period of extreme inflation, when a rate base equal in dollars only to the original cost incurred prior to the period of inflation would be manifestly unjust, the commission would adopt means to make the rate base reflect the decreased value of the dollar, or it would permit reproduction cost estimates to be shown. If it failed to do this, the Court, upon review could grant relief.

Such a pronouncement as we are suggesting would restore to the commission the right to exercise judgment, which the court intended to preserve under its opinion in the *Smyth v. Ames* case.

In the *Pacific Gas and Electric Co. case* this Court restored the rule. What is now needed is a declaration which shall make clear the full import of that decision, so that a commission may exercise its judgment as to whether the rate base ought justly to be determined upon consideration solely of original cost evidence, or of reproduction cost evidence, or of both; and so that, when it has determined that either class of evidence will not be helpful, it may refuse to receive the same.

#### **The Pronouncement of the Court in the Natural Gas Pipe-line Company Case.**

In the *Natural Gas Pipeline Company case* the Court made a pronouncement, which, as we construe that opinion, fully covers this case, and establishes the right of a rate regulatory commission to exercise its judgment as to the method whereby it will find the rate base, provided only that the demands of due process are duly met. In its opinion the Court said:

“By long-standing usage in the field of rate regulation the ‘lowest reasonable rate’ is one which is not confiscatory in the constitutional sense.”

“The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of ‘due process’ have been overstepped. If the Commission’s order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end.” (315 U. S. 575, 586)

As we understand that pronouncement, every rate regulatory commission is free to adopt such valuation methods as in its judgment will enable it to determine rates which are "not confiscatory in the constitutional sense," provided that it acts after a fair hearing, makes findings which meet the requirements of the constitutional rule, as declared by this Court, and provided that it satisfies the requirements of the statute under which it acts.

If an order so made is complained of, the Court is not concerned with the formula which the commission has followed in finding the rate base, but only in determining whether the order "viewed in its entirety" produces a result which impresses the judicial sense as arbitrary and beyond the bounds of reason.

#### **The Occasion for an Amplification of the Pronouncement of the Court in the Natural Gas Pipeline Company Case.**

If our construction of the pronouncement of the Court in the *Natural Gas Pipeline Company case* is correct, we believe that it leaves the law in exactly the form in which it should be. We urge that the Court should not prescribe any formula for the finding of the rate base, but should leave legislative rate-making agencies free to exercise discretion and judgment, subject only to the power of the Court to relieve from a rate order manifestly arbitrary, because not made upon a due process of law hearing, or not supported by substantial evidence.

Under the pronouncement, as we construe the same, a regulatory commission which determines that a fair rate base may be found by using the original cost method, followed by the commission in this case, may not only permit such evidence to outweigh reproduction cost evidence which may have been offered and received, but it may refuse to admit such reproduction cost evidence, for the reason that the same will not be usable under the formula adopted by the commission.

Contentions made in this case, and the opinion of the court below, make it clear that the pronouncement in the *Natural Gas Pipeline Company case* is not given the construction which we have attributed to it by some able utility counsel and by some judges of eminence. It is, accordingly, suggested that it will aid regulatory commissions, federal and state, in the performance of their respective duties, in the regulation of rates or in the review of rate regulatory orders, if the Court will so amplify the pronouncement as to make its meaning clear beyond misconception.

In this connection, it is suggested that, as a result of the long continuance of the so-called fair value rule, establishing rights under the federal constitution, it has come about that the laws of the states generally, under the specific provisions of state constitutions or statutes, or under decisions of the state courts expounding such constitutions or statutes, require that rates prescribed by state regulatory agencies must afford a fair return upon "Value." A pronouncement, accordingly, declaring that, under the Natural Gas Act, the Federal Power Commission should base rates upon net investment would not relieve state regulatory agencies from the duty to conform their acts to the requirements of applicable laws, whereas a pronouncement making it plain that value, in the sense that such term is used in the decisions of this Court, dealing with the constitutional rights of carriers and public utilities, may be found by a regulatory commission by any formula which is consistent with the requirements of due process, will undoubtedly be accepted as guiding by the state courts, in cases involving application of the laws of their respective states.

#### **The Commission Did Not Err in Its Determination of Accrued Depreciation.**

The Commission used the straight-line method in determining the amount of accrued depreciation, and computed such depreciation upon the original cost of the property

depreciated. Use of the straight-line method was approved by this Court in the *Natural Gas Pipeline Company case*. 315 U. S. 575.

In applying the straight-line method, the Commission properly computed the depreciation upon the basis of the original cost of the property involved. This point was discussed in the brief filed by the Association in the *Natural Gas Pipeline Company case*. The paragraphs appearing below, under the caption "Paragraphs from the Association's Brief in the Natural Gas Pipeline Company Case Discussing the Determination of Depreciation" are deemed applicable in this case.

**Paragraphs from the Association's Brief in the Natural Gas Pipeline Company Case Discussing the Determination of Depreciation.**

The gas companies contend that the amount to be amortized is the present fair value of their property. They rely upon the opinion of this court in *United R. & E. v. West*, 286 U. S. 234, 253. That opinion unquestionably supports their claim. We submit that the opinion is unsound and should be overruled.

The opinion is unsound because it lays down a rule which it is impossible for regulatory commissions to adopt and follow.

Such commissions have been given authority to issue orders, and to require annual or periodic reports, so that the true financial results of the operations of regulated properties may be readily known to the commissions. Orders prescribing charges which may be made to operating expenses for depreciation must be, accordingly, orders which the regulated companies may understand and comply with, and they must be orders failure to comply with which may be readily observed and proved, so that the commissions can enforce the same.

It is not possible to frame an accounting order, to provide for the charging to operating expenses of depreciation of the various classes of utility property to be determined, upon the basis of the fluctuating cost of reproducing such property, which will enable the regulated companies to know the amounts which they are required to charge, or which can, as a practical matter, be enforced by the commission making the order.

For this reason, we believe it to be true that not a single regulatory commission, federal or state, has undertaken to conform its order respecting depreciation accounting to the rule laid down in *United R. & E. Co. v. West*.

The infirmities of that rule were pointed out in the dissenting opinion of Mr. Justice Brandeis. The almost universal practice in the business world, as pointed out in that opinion, is to base depreciation charges in accounting upon cost.

In determining the allowance to be made to operating expense in rate cases, it should be kept in mind that the rate proceeding is in no proper sense a determination of an amount to be paid to the owners for the taking of title to their property. It is, in fact, merely a determination, by public authority, of the amount which ought properly to be paid by the public for the services rendered by the enterprise, and covered by the rates to be fixed.

In determining that compensation, workable methods ought to be adopted which reasonably protect the owner and the public. If the practice is followed of charging the cost of property to operating expense in proportion to its consumption, year by year, in conformity with established business usage, the rights of both the public and the owner will be protected.

Under the *Smyth v. Ames* opinion (169 U. S. 466), among the matters to be considered and attributed proper weight by a regulatory agency is "the sum required to meet operating expenses." To enable such expenses to be estimated for consideration, it must be open to the rate-making agencies to compute the same upon some rational and practi-

cable basis. We maintain that if the rate-making agency, in the exercise of its judgment, adopts a method for determining the expense of annual depreciation which accords with the common practice of the business world, it is within the *Smyth v. Ames* rule, and that its determination can not properly be held arbitrary or otherwise unconstitutional by any reviewing Court.

**The Commission Properly Excluded Well Drilling Costs and Overhead Costs Connected Therewith Which When Paid Were Charged to Operating Expenses.**

The Commission properly excluded well drilling costs and overhead costs connected therewith which the company had charged to operating expenses when such costs were incurred. These costs were for well drilling operations in the early history of the company, prior to 1923. They aggregated approximately \$17,000,000, when incurred. If included, and subjected to depreciation, they would now amount to around \$4,000,000 (AR. Vol. IV, p. 184).

Under Accounting regulations now in effect, costs of this character are required to be charged to capital, but at the time these costs were incurred there was no such regulation. Hope then elected to charge them to operating expenses. They were so charged; and Hope was fully reimbursed by revenues received from rates. Such revenues were adequate to pay all operating expenses and a handsome return upon capital, as well. During the 25 years in which Hope followed the practice of charging such costs to operating expenses, it earned an average return, above operating costs, of approximately 15 per cent upon its outstanding stock and accumulated surplus. (R. Vol. I, p. 34; R. Vol. III, pp. 13-14.)

These cost items were charged by Hope to operating expenses in accordance with a determined policy, long continued. By following that policy Hope, a public utility, made its operating expenses appear larger, by the amount

of the items so charged, than they would have been had such items been charged to capital. The commission in its opinion properly said:

“There must also be some finality to these decisions. If they are treated as expenses at one time and as plant investment subsequently, chaos in rate-making and in corporate finance will prevail.”

To permit a public utility to swell its apparent operating cost by charging capital items to operating expenses, which it thereafter withdraws and adds to capital, operates as a fraud upon the public. It makes no difference whether the public utility is, at the time of following such practice, subjected to regulation or not. The public is entitled to a fair statement in the accounts of the utility, and in its financial reports, as to its operating costs.

This is true because, whether regulated by a rate-making agency or operating without such regulation, the right of the public utility to compensation for the services which it renders is limited to rates which are reasonable; and the level of reasonableness is determined upon consideration of operating expenses, among other factors. This is true whether the rate payer may appeal for protection against exorbitant charges to a regulatory commission, or must assert his rights in the courts.

Furthermore, the public, in determining whether to create a commission for the regulation of a public utility industry, may be governed by the extent of the profits above expenses which utilities in that industry are exacting from the public. Public policy accordingly requires that honesty and consistency shall be observed in public utility accounting.

Whatever may have been its purpose, Hope has exercised the freedom which has been allowed it, with respect to its manner of keeping its accounts, by charging to operating expenses not only these items which it now claims ought to have been charged to capital cost, aggregating \$17,

000,000, but also by charging to operating expenses, as for depreciation, amounts aggregating more than \$16,000,000 beyond the actual accrued depreciation, as found by the Commission. (R. Vol. I, p. 81). By these practices, the operating profits of Hope were made to appear \$33,000,000 less than they would have appeared had the charges not been made to operating expenses.

Furthermore, Hope was not only a public utility, subject to public regulation whenever public regulation should be imposed by appropriate authority, but it was in fact subjected to public regulation in West Virginia, with respect to its sales within that State, under Chapter 9, West Va. Laws of 1913. Before the Public Service Commission of that State Hope actually used its operating expenses, including the costs for well drilling and accompanying overheads, which are the subject of this discussion, to support an application for increased rates. (Re *Hope Natural Gas Co.*, P. U. R. 121, E. 418, 440)

In other later proceedings, involving another company, claim was made before the West Virginia Commission, that similar costs, which had been similarly charged to operating expenses, should be included in the rate base. The Commission refused such inclusion, and was sustained by the Supreme Court of Appeals of the State, in *Natural Gas Co. v. Public Service Commission*, 95 W. Va. 557. At a yet later time, the same Natural Gas Company, in another rate proceeding, in which it was resisting a petition for a rate reduction, repeated its claim. In that case the Commission denied the reduction, upon consideration of a valuation made by it, which appears to have taken into account these items of claimed capital cost, which had been charged to operating expenses. Upon an appeal, the Supreme Court of Appeals of the State set the Commission's decision aside, upon that and other grounds, in an opinion in which it said:

"In the instant case, as already indicated, the overheads and the items of physical property now sought to

be capitalized were charged to operating expenses, and the rates apparently fixed on that basis. For the company now, by virtue of a change in accounting, to attempt to capitalize such items, is certainly not just or proper, under our decisions." (*City of Wheeling v. Natural Gas Company*, 115 W. Va. 149)

**The Commission's Order, Viewed in Its Entirety, Produces No Arbitrary Result.**

No complaint is made that Hope was not afforded a fair hearing. The rate base finding, as we have shown, conforms to the requirements of decisions of this Court. The Commission proceeded in conformity with the statute under which it acted. Finally, the order, viewed in its entirety, produces no arbitrary result.

The rate base used exceeds the original cost less depreciation. The cost of unoperated gas acreage was reflected in the rate base. More than \$16,000,000 which Hope had charged to operating expenses, was restored to capital, and included in the rate base. And upon that rate base the Commission allowed rates to yield the generous return of 6½ percent. (That this return was adjudged "low" by the Court of Appeals may perhaps indicate an unconscious disposition on the part of the court to view critically the Commission's order, rather than a disposition to approach consideration of it in the spirit which would seem to be dictated by the rule which we are now invoking.)

This return of 6½ percent may be contrasted with barely more than 5 percent, allowed to a utility by the Illinois Commission, in a rate order, which finally came before this Court. The order was sustained by the Illinois Supreme Court, and an appeal from the judgment of that court to this Court was held to present no substantial federal question. *Peoples Gas Light and Coke Co. v. Hart, et al*, 367 Ill. 435, 287 Ill. App. 377, 373 Ill. 31, 309 U. S. 634.

If the rate of return used in this case had been 5 percent, as in the *Peoples Gas Light and Coke Co. case*, instead of 6½ percent, that would have operated to decrease the fair

return allowed by \$505,687.89. On the other hand, if \$17,000,000 for well drilling and related costs, which Hope claims should have been included, had been included, and subjected to appropriate reduction for depreciation, the rate base would have been increased by approximately \$4,000,000, as has been before shown. Upon that increase 5 percent would have yielded \$200,000, or less than one-half of the amount by which the 6½ percent has increased Hope's earnings above that which it would have received under the return found adequate by the Court to meet constitutional requirements in the *Peoples Gas Light and Coke Company case*, just cited. Also if these items for well drilling and related costs had been included, and the full amount which Hope has charged to operating expenses, as depreciation, had been deducted, the rate base would have been \$12,000,000 less than the rate base which the Commission found and used.

There are no costs incident to establishing Hope's business which have not already been recouped, through returns received in the past. Indeed, over its entire history, up to 1940, Hope's stock, issued for cash or other assets, has earned an average yield of 20.4 percent per annum (R. Vol. III, p. 15).

Of its entire issue of \$35,000,000, all common stock, \$16,969,300 was issued for cash or other assets. Up to January 1, 1941 it had paid out dividends in cash amounting to \$97,273,640 (R. Vol. III, p. 15) and had accumulated a cash surplus as of that date, amounting to more than \$8,000,000 (R. Vol. III, p. 17, Schedule 4).

Upon all of its stock outstanding in the past, including that issued in stock dividends, Hope has paid an average of 14 percent on common stock. The Commission's rate order was designed to produce a fair return of \$2,191,314. This is 5 percent upon upwards of \$43,800,000. It will enable payment of more than a 6 percent return upon the entire volume of Hope's stock outstanding, both that which was issued for cash or other assets, and that which was issued

in stock dividends; and it amounts to 12.9 percent upon all such stock which was issued for cash or other assets.

Such an order, issued upon such a record as was before the Commission, does not call for the intervention of a court of equity, to prevent confiscation. The demand for such intervention must arise from a feeling that long acquiescence by the public in the collection of an unduly high return creates a vested right to demand a continuance of that happy experience.

#### CONCLUSION.

Upon matters not argued in this brief, which are involved in this case, we concur on the argument made by counsel for the Federal Power Commission, and the Pennsylvania Public Utility Commission, Petitioners, filed herein.

The judgment below should be reversed.

Respectfully submitted on behalf of the National Association of Railroad and Utilities Commissioners.

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October 15, 1943.